Commission conditionally approves PJM reliability pricing settlement intended to ensure adequate power supply

(FERC press release)

The Federal Energy Regulatory Commission today approved, with conditions, a broad settlement agreement intended to ensure reliability and provide for just and reasonable rates in the 14-state PJM Interconnection region.

“There is a growing electricity supply problem in PJM. The problem has grown to the point where PJM has claimed reliability has been degraded in New Jersey, and reliability problems will expand to other parts of Eastern PJM,” observed Commission Chairman Joseph T. Kelliher. “In essence, this problem is caused by increasing demand, combined with a slowdown of new entry and a surge in generator retirements. Just as we saw in New England, this problem will not resolve itself. It requires Commission action. I commend the parties to the settlement for developing a regional solution to this regional problem, and am pleased to approve the settlement.”

In today’s decision, the Commission emphasized that it had a substantial record showing that the existing approach to assuring necessary quantities of electricity is unjust and unreasonable due to several factors, including that the existing approach leads to volatile prices and does not provide incentives for generators to locate in the geographical areas where they are most needed.

PJM, which operates the largest competitive wholesale electricity market in the nation, is responsible for overseeing the obligations of its Load Serving Entities (LSEs) to ensure sufficient electricity supplies to fulfill its reliability requirements.

PJM has stated that, from time to time, localized areas have had difficulty meeting reliability requirements. PJM expects the problem will extend to other PJM areas and has been working to develop a comprehensive plan to retain existing generation and encourage the development of additional resources necessary to resolve reliability problems.

In an April 2006 order, the Commission agreed that PJM needed to replace its existing rules to assure necessary quantities of electricity. The order established procedures to work out a new proposal setting the stage for the settlement talks.

The Commission stated in today’s order that PJM’s current energy markets do not provide for sufficient revenue to assure reliability, given the constraints imposed by price caps and mitigation and other factors. It found that the plan set forth by the settlement, by providing for a three-year forward market in better-defined geographic markets, along with a mechanism for pricing based on the amount of supply within each localized area in excess of the required minimum (downward sloping demand curve), is superior to PJM’s existing approach to assuring sufficient electricity resources. Based on the evidence at hand, the Commission concluded that the settlement should secure sufficient resources to meet PJM’s reliability requirements at just and reasonable rates.

Key elements of PJM's Reliability Pricing Model (RPM) accepted today include:

* Determination of prices through use of a downward-sloping demand curve. This is a mechanism to price supply within each local area so that prices change gradually based on the balance between the amount of supply offered and the amount required for reliability. It encourages investment by increasing revenue stability over time. It also better indicates the incremental value of capacity at different capacity levels than the current mechanism, where prices change abruptly with small changes in supply around the reliability requirement. In addition, this mechanism is anticipated to reduce the incentive for sellers to withhold capacity in order to exercise market power by decreasing the potential to obtain excessive profits through market manipulation. Further, the settlement includes a provision under which qualifying utilities that prefer not to participate in this mechanism may choose instead to fulfill their own reliability responsibilities.

* Forward procurement. Under the settlement, load-serving entities must make commitments to procure a sufficient supply of energy three years ahead, rather than the shorter term commitments that are common now.

* Locational pricing phase-in. The settlement provides that PJM will create 23 Locational Delivery Areas for the determination of prices, but that division of the market will be completed incrementally through delivery year 2010-2011, so as to allow time for market participants to realign their contractual obligations.

The Commission supported the use of locational pricing, noting that it provides appropriate price signals to provide incentives to construct facilities within the specific areas that most need the additional resources for reliability.

The settlement is conditioned on PJM filing changes to the provisions that discriminate between those parties signing the settlement and non-signatories; changing provisions giving inappropriate discretion to the PJM Market Monitor; and revising the tariff to enable a greater number of resources to receive expedited cost recovery treatment.

The Commission also directed PJM to conduct a forum for discussions to identify and remedy barriers to demand response entry and to file a report on the status of the additional process for pursuing demand response and incorporating energy efficiency applications.

Today's order also denies rehearing of the Commission's finding in the April 20 order that PJM's current capacity market rules are not just and reasonable.

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